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In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. P. CLARK

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

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DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

R. P. CLARK

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals of the District of Columbia entered in the above cause on April 11, 1932, reversing the judgment of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 15–17) is reported in 19 B. T. A. 859. The opinion of the Court of Appeals (R. 27) is not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered April 11, 1932. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under the circumstances of this case, the losses sustained in 1921 by respondent by reason of the payment of certain notes of the Bowers Southern Dredging Company which he had endorsed, and in 1921 and 1922 from the sale of certain stock of that corporation, constituted "net losses resulting from the operation of any trade or business regularly carried on by the taxpayer" within the meaning of Section 204 (a) of the Revenue Act of 1921.

STATUTE AND REGULATIONS INVOLVED

The applicable statute and regulations are set forth in the Appendix, *infra*, pp. 9–11.

STATEMENT

The pertinent facts, as found by the Board of Tax Appeals (R. 10–15), may be summarized as follows:

Since 1888 respondent, R. P. Clark, has been engaged in the business of dredging and supervising dredging operations. He was associated with the Bowers Southern Dredging Company from the date of its organization in 1899 until September, 1922. That company was engaged in dredging and other river, harbor, and jetty work. Respondent became president and active directing head of the

Bowers Company in 1905 and so continued and devoted all of his time to its operation during that time. In September, 1922, respondent became president of the Clark Dredging Company which was then organized and took over the business of the Bowers Company. (R. 11–12.)

In 1921 and 1922 respondent owned, as investments, stock in a number of corporations, and in addition to his activities in the Bowers Company, was a member of and took an active advisory interest in three partnerships. The partnerships were engaged in the business of dredging, river and harbor work, and jetty building, mostly in connection with the work of the Bowers Company. (R. 12.)

At the beginning of the war in 1917, the Bowers Company had many contracts to complete and began to experience financial difficulties. This finally resulted in its business being placed in the hands of a creditors' committee under which it was operated in 1921. During this time respondent, majority stockholder in the Bowers Company, served as managing operator of the company for the creditors' committee and continued as such until the Clark Company succeeded to the business in 1922. The Bowers Company was unable to borrow money from banks without the individual indorsement of respondent. Therefore, in order to protect his investment in the company, respondent at various times became indorser upon notes of the

company. In 1921, as a result of such indorsements, respondent was forced to pay the sum of $68,000 for the company. This amount, together with a loss of $9,500 suffered by him in the sale of the Bowers Company stock in 1921, respondent took as a deduction for losses on his 1921 income-tax return, and the deduction was allowed by the Commissioner in the final audit of the return. (R. 12–13.)

In 1922 respondent, being desirous of having some one with financial strength associated with the business of the Bowers Company, sold 1,000 shares of the stock owned by him in the company, which he had purchased at a cost of $100,000, to George H. Nolan for $7,500. In his return for 1922 respondent accordingly took a deduction for the loss thus sustained in the amount of $92,500, which represented the difference between the cost and selling price of the stock. In the final audit of the return this loss was allowed by the Commissioner. (R. 14–15.)

Respondent's income for 1921 and 1922 was not sufficient to absorb the losses sustained in those years but left remaining unabsorbed net losses of $17,768.51 in 1921 (R. 13), and $4,985.10 in 1922 (R. 15). Respondent claimed the right, under Section 204 of the Revenue Act of 1921, *infra*, p. 9, to carry these sums forward and deduct them in his tax returns for succeeding taxable years as "net losses resulting from the operation of any

trade or business regularly carried on by the taxpayer." The Commissioner disallowed deduction on respondent's 1923 return of the "net losses" thus claimed. (R. 6–9.) The Board of Tax Appeals sustained the Commissioner's determination on the ground that the losses resulted from isolated or occasional transactions. (R. 10–11, 16–17.)

The taxpayer, under stipulation entered into pursuant to Section 1002 (d) of the 1926 Revenue Act, filed his petition for review in the Court of Appeals of the District of Columbia (R. 18–19), which reversed the decision of the Board of Tax Appeals.

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals of the District of Columbia erred:

1. In holding that the losses sustained by ~~petitioner~~ respondent were "net losses resulting from the operation of any trade or business regularly carried on by the taxpayer" within the meaning of Section 204 (a) of the Revenue Act of 1921.

2. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below, citing with approval *Washburn* v. *Commissioner,* 51 F. (2d) 949 (C. C. A. 8th), is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Dalton* v. *Bowers,* 56 F. (2d) 16 (C. C.

A. 2d). We did not oppose the petition in the *Dalton* case beause of the apparent conflict between the decision in that case and the decisions in the *Washburn* case and the instant case and because of the importance of the question. Certiorari was granted on May 31, 1932 (No. 52, October Term, 1932).

In the *Dalton* case, the taxpayer, an inventor and engineer, had organized the Dalton Manufacturing Company, a New York corporation, of which he became the president, treasurer, and a director. He owned all the capital stock, which cost him $395,000, and made unsuccessful efforts to sell the stock to the public. He devoted his time to inventing. The Dalton Manufacturing Company was employed in manufacturing and marketing articles of his invention. He was in active charge of the company and its affairs, and from its incorporation until September, 1924, spent the greater part of his time at its office, receiving no compensation for his labors, although he was credited with a salary from 1917 to 1922, inclusive. In December, 1923, the liabilities exceeded the assets by $173,462, and in that year it ceased operations and took steps to wind up its business. Its assets were sold during 1924. The profits of the sale were insufficient to pay its creditors. However, the taxpayer advanced sufficient funds to the corporation for that purpose and he had earlier advanced other sums to it. It was not actually dissolved until 1925, when the taxpayer surrendered his stock for cancellation. In his re-

turn for 1925 he claimed a deduction for the loss sustained in 1924 when his investment in the stock of the corporation became worthless, pursuant to Section 206 (a) and (b) of the Revenue Act of 1924, as a loss "attributable to the operation of a trade or business regularly carried on by the taxpayer." The Circuit Court of Appeals, reversing the judgment of the District Court, held that the Dalton Manufacturing Corporation was a legal entity, separate and distinct from Dalton, its stockholder, and that inasmuch as Dalton chose to do business through the corporation, his loss was a capital loss and did not occur in the operation of a trade or business regularly carried on by him. Despite the differences in fact, the application of the same principles to this case and the *Dalton* case would doubtless have changed the result in one of the two cases.

The decision of the court below appears also to be in conflict with the principles applied in *Anderson* v. *United States* 48 F. (2d) 201 (C. C. A. 5th); *Eli Strouse* v. *Commissioner* (C. C. A. 4th), decided June 13, 1932, not yet reported; *Hughes* v. *Commissioner,* 38 F. (2d) 755 (C. C. A. 10th); *Goldberg* v. *Commissioner,* 36 F. (2d) 551 (App. D. C.); and *Pabst* v. *Lucas,* 36 F. (2d) 614 (App. D. C.).

2. For the reasons stated in the memorandum submitted on behalf of the Government in the *Dalton* case, the question whether losses incurred as a

creditor or a stockholder of a corporation by a taxpayer who is actively engaged in the management of an incorporated enterprise are deductible "net losses" under the applicable Revenue Acts is of general importance. We believe that the decision of the court below in this case was erroneous. In order to preserve the rights of the Government pending the consideration of the question in the *Dalton* case, it is respectfully submitted that the present petition should be granted.

In the event that this Court grants the petition, it is suggested that this case be assigned for argument immediately after the *Dalton* case.

THOMAS D. THACHER,
Solicitor General.

JUNE, 1932.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

REVENUE ACT OF 1921 C. 136, 42 STAT. 227, 231

SEC. 204. (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); and when so resulting means the excess of the deductions allowed by section 214 or 234, as the case may be, over the sum of the following: (1) The gross income of the taxpayer for the taxable year, (2) the amount by which the interest received free from taxation under this title exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not permitted to be deducted by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234, (3) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gains or profits not derived from such trade or business, (4) amounts received as dividends and allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil or gas well as is based upon discovery value in lieu of cost.

(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

TREASURY REGULATIONS 62

ART. 1601. *Net losses, definition and computation.*—The term "net loss" as used in the statute means only a net loss resulting from the operation during the taxable year of any trade or business regularly carried on by the taxpayer. Included therein are losses from the sale or other disposition of real estate, machinery, and other capital assets used in the conduct of such trade or business. In order to be entitled to claim an allowance for a "net loss" the taxpayer must have suffered an actual net loss in a trade or business during the taxable year. The amount properly allowable may be neither the loss reflected upon the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute, as follows:

(1) In the case of an individual, it is the amount by which the deductions allowed under section 214, excluding:

(a) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gain or profits not derived from such trade or business;

* * * * *

(c) the amount of deductions allowed under section 214 not connected with the trade or business,

exceeds the sum of the following:

(a) the gross income of the taxpayer for the taxable year as computed under section 213; and

(b) the amount by which the interest received free from taxation under the provisions of the Act exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not allowed as a deduction under section 214 (a) (2).

* * * * *

In computing statutory "net loss" the following restrictions are to be noted:

(1) Interest received by the taxpayer on obligations or securities, the interest from which is exempted from taxation must be included in income, but this amount may first be reduced by the amount of any interest paid by the taxpayer on money used to purchase or carry such obligations or securities.

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